Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	CC Docket No. 96-45
Federal-State Joint Board on	)	
Universal Service	)	

COMMENTS OF VERMONT PUBLIC SERVICE BOARD ON FURTHER NOTICE OF PROPOSED RULEMAKING

On October 16, 2003, the Commission adopted an Order ("Order") and Further Notice of Proposed Rulemaking ("FNPRM") concerning universal service.[1] The Commission requested further comment on issues related to the rate review and expanded certification process that it adopted in an Order issued in the same date. The Vermont Public Service Board ("Vermont Board") is pleased to have the opportunity to submit the following comments.

EXECUTIVE SUMMARY

The Commission should reexamine its decision to base supplemental support on local exchange rates. If it decides to go forward, it will have to solve difficult methodological problems. It will have to require rate reporting from substantially all of the country, and it will have to develop both reliable data and specific adjustments for five factors that make bare rate data essentially arbitrary. In the alternative, the Commission could still move forward on a rates-based supplemental support program if it used total intrastate revenues per line as the single input element. This data point solves all five of the problems identified with using local exchange data.

[1] FCC No. 03-249 (released on October 27, 2003).

For those states that succeed in becoming eligible for supplemental support, the Commission should not calculate that support based on the cost proxy model. Support based on that model already provides 100 percent of above-benchmark costs, and providing more would be neither sufficient nor consistent with the reasoning the Commission has repeatedly adopted for statewide averaging.

The Commission should not use its Section 254 power to induce states to alter intrastate rate designs. The 1996 Act preserves state authority under section 152(b), and the Commission cannot condition federal support upon a state commission acquiescing in the Commission's preferred allocation of joint intrastate costs or in adopting rate designs preferred by the Commission.

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I. FILING ADDITIONAL DATA

The FNPRM asked whether, in connection with state reasonable comparability certifications, states should be required to file additional data that might enhance the Commission's ability to assess the non-rural mechanism and state actions to achieve comparability of urban and rural rates, including business rate data, and rate data for non-rural areas served by non-rural carriers. It also asked whether all states should submit rate data to the Commission in connection with the rate review and expanded certification process, in order to establish a more complete picture of state efforts to achieve rate comparability. The FNPRM inquired whether collecting additional rate data from all states would improve the Commission's ability to assess the reasonable comparability of rural and urban rates nationwide through the rate review and expanded certification process.

A. Reliable Data, Specific Adjustments and Predictable Support

If the Commission goes forward with its new concept of rates-based support, rate data must be valid and reliable.[2] This requires the Commission to collect additional data, beyond nominal rates, that affect the burden of paying for local exchange service as well as the value of that service. Oversimplified rate information can underestimate the real burden on consumers and can create perverse incentives for states and carriers. If the Commission does not solve the methodological problems described below, nationwide rate data would be at best highly random and at worst misleading and arbitrary. The Commission should then use that additional data to make specific normalizing adjustments to reported rates before basing any support decisions on that data.

Specific and prescribed adjustments are essential if support is to be predictable.[3] As the Board said in earlier comments,[4] the Commission should issue some advance guidance about how it will adjust or normalize rates for these important differences. Without that advance guidance, states will be forced to struggle for years to develop acceptable petitions for supplemental support that will produce predictable results.

Daunting data collection problems need to be solved before a rate-based support method can produce sufficient support. These problems previously led the Commission in all previous orders to consider cost as a preferred surrogate for rates, and that approach has been affirmed by the Tenth Circuit. For reasons explained below, the Commission should reconsider its fundamental conclusion that rates-based support can eventually be made to produce specific, predictable and sufficient support, without also providing needless support in some areas. However, if the Commission desires to move forward with rates-based support, notwithstanding these difficulties, to develop valid and reliable local rate data it should make five adjustments: usage-sensitive charges; local calling area size; customer option plans; local/toll balance; and business/residential balance. As discussed below, all of these adjustments can be made simply with one decision, to use average intrastate revenues per minute as the sole indicia of current ratepayer effort.

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[2] Validity means that the commission is actually measuring that which it purports to measure. Reliability means that the data collected consistently reflect the information sought. Reliability is capable of being measured statistically.

[3] 47 U.S.C. § 254(b)(5).

[4] Comments on Joint Board Recommended Decision by Montana Public Service Commission, Montana Consumer Counsel, Vermont Public Service Board, and Vermont Department of Public Service, filed Dec. 20, 2002, at 39.

1. Usage-Sensitive Charges.

Usage sensitive charges for local exchange can greatly change the total cost of that service. In some states, including Vermont, the burden imposed by such charges is significant, and they cannot be overlooked in any support system based on local exchange rates.

The data published in the Wireline Competition Bureau's *Reference Book,* in some cases, considers usage charges when determining characteristic rates. In areas where flat rates were not available, the *Reference Book* calculated a " representative rate." However, for both residential and business customers, if flat-rated service was unavailable, the rate for measured/message service was used, along with the charges associated with placing 100 five-minute, same-zone, business-day calls.[5]

There are two problems with the *Reference Book* method. First, where unlimited or flat-rated service is available, the *Reference Book* always used those rates. This is not an appropriate policy when a substantial portion of subscribers must actually pay local exchange usage charges. Where a majority of customers actually subscribe to a different plan, the flat rate is not a reliable indication of the average customer's burden.

Second, and more important, the method currently used to measure rates in areas with local measured service ("LMS") rates underestimates the actual burden of usage charges. Based on the preceding numbers, the *Reference Book* assumes that the average customer will make 3.3 calls per day and will use the network 16.7 minutes per day.

[5] *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service, 2003*, Federal Communications Commission, Industry Analysis Division, at I-2, I-3.

Verizon Vermont reports much greater usage than that assumed in the *Reference Book.* The Commission's published data show that Verizon-Vermont has 360,411 USF loops,[6] and its customers made 767,427,000 local calls.[7] The ARMIS system shows that Verizon-Vermont has a local DEM of 6.38 billion minutes.[8] This means that the average Verizon-Vermont customer makes 5.9 calls per day, 77 percent more than assumed in the *Reference Book*. That customer spends an average of 49 minutes per day on the phone, almost three times as much as that assumed in the *Reference Book*.

National data show even higher network usage. ARMIS carriers reported 3,909 billion minutes of local DEM usage in 2002.[9] These same companies reported 173.7 million USF loops.[10] This produces an average of 62 minutes per day of average usage, 271% more than was assumed in the *Reference Book*. Nationwide, carriers reported 509 billion local calls. That works out to eight calls per day, not three.

These data demonstrate that the Commission cannot adequately estimate the cost of local exchange service in areas using local measured service charges by assuming that customers make 100 calls per month of five minutes each. The assumptions in the *Reference Book* greatly underestimate actual usage. They would greatly underestimate the actual cost of local service charges where those charges are imposed. This issue is particularly important for Vermont since

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[6] *Statistics on Common Carriers*, 2003, Federal Communications Commission, Table 5.1. Verizon-Vermont reported 348, 670 billable access lines in 2002. ARMIS Report 43-01 (from Commission's web site).

[7] *Id.*, table 2.5.

[8] ARMIS data taken from inputs to Commission's Hybrid Cost Proxy Model, using 2002 data intended for 2004 support calculation.

[9] *Id.*, table 5.8.

[10] *Id.,* table 5.1.

most Vermont incumbent local exchange carriers impose some form of local measured service charge.

Instead, the Commission should seek methods of measuring the real monetary cost of local exchange service. One simple way to do this is to abandon the effort to arrive at a "representative rate" and use average carrier basic exchange revenues per line. This automatically measures customer effort, and no other assumptions are needed about what is or is not "representative." Actual network usage, flowing through actual local rates, would drive the revenue data inputs to the support calculation. This is the best method, in our view, to solve this problem.[11]

If usage data is not collected properly, the Commission will inadvertently be establishing an incentive for high-cost states to abandon local measured service rate designs in favor of flat-rated local calling. The Commission may wish that states would adopt flat-rated rate designs, but this nevertheless is a matter within state authority. Rate design policies for intrastate services remain within the legitimate discretion of state commissions. 47 U.S.C. § 152(b). This remains true, even after the 1996 Act.[12] The Commission should not make federal support contingent on states surrendering jurisdiction over intrastate rates. Even if it insists upon going forward with

[11] Another method is to retain the effort to define a "representative rate," but use realistic local usage data. The existing ARMIS reporting system apparently already collects all the required usage information for all or nearly all nonrural carriers.

[12] The Telecommunications Act of 1996 expressly disclaimed any implied effect of preemption. In an uncodified section, it provided as follows:

> (1) No implied effect. - This Act and the amendments made by this Act shall not be construed to modify, impair, or supersede Federal, State, or local law unless expressly so provided in such Act or amendments.

Pub. L. 104-104, title VI, § 601(c)(1), Feb. 8, 1996, 110 Stat. 143 (text reprinted in note following 47 U.S.C.A. § 152 (West 2001)).

rate-based support, it can minimize the damage to the intrastate jurisdiction by accurately measuring the burden of local measured service rates.

2. Local Calling Area Size

Local calling areas vary considerably from state to state, and sometimes even within a single state. In some areas nominal local exchange rates are low, but customers are forced to make short-haul toll calls for routine local services.

Data from numerous sources testify that calling area size has a powerful influence on local rates. For example, many of the highest rate areas in the GAO study are known to have very large calling areas. Thus the local exchange rate data collected by the GAO and by the Commission may be as much a reflection of the size of local calling areas as it is an indicator of the true burden imposed by local exchange rates. If so, the local exchange data will not, by itself, be valid.

The Order even recognizes the importance of the calling area sizes. It notes the significant toll bills paid by customers of rural telephone companies with small local calling areas.[13] Also, the Commission sought comment on whether it should encourage states to consider calling area size information in their own rate review processes.[14] In these ways, the Commission recognizes the importance of local calling areas. It is difficult to understand why, if the states may be encouraged to consider this data, the Commission should not do likewise.

[13] Order, ¶ 25 ("customers of rural carriers tend to have a relatively small local calling scope and make proportionately more toll calls").

[14] Order, ¶ 113. The questions under consideration included 1) whether states should "be encouraged to consider the calling scopes available in rural areas served by non-rural carriers in assessing rate comparability"; 2) whether the Commission should incorporate calling scopes into the safe harbor; ? 3) If so, how that would be done; and 4) to what extent consideration of calling scopes would increase the burdens associated with the rate review process.

Nevertheless, the Order rejects making any support adjustment based on calling area size.[15] The Commission correctly notes that rates cannot be "adjusted for any conceivable difference in local rate design policy,"[16] and that it will be difficult to find a simple and fair method to correct for these differences.[17] Nevertheless, it may be possible and necessary to adjust, if not for "all conceivable" differences, at least for particularly important differences.

The Commission should reconsider its decision not to account for local calling size when calculating federal support. If it does not, high-cost states will have an incentive to redesign local calling areas in a way that increases local rates by expanding local calling scope. The Commission should not, in the name of promoting universal service, create financial incentives for states to redraw local-toll boundaries. As explained above, rate design policies for intrastate services remain within the legitimate discretion of state commissions. The Commission should not make federal support contingent on states surrendering jurisdiction over intrastate rates.

Another side effect of larger calling areas is a smaller market for toll calls, and thereby a smaller market for third-party interexchange carriers. In many states, the intrastate toll market is the most competitive telecommunications market, and reducing this market would be anti-competitive. Another effect could be to increase local exchange rates, making them less affordable to low-income customers and increasing the demand on lifeline support programs.

The Order said that, in the context of rate reviews and expanded certification, the Commission will "allow states to bring factors other than basic service rates to our attention if

[15] Order, ¶¶ 42, 59.

[16] Order, ¶ 59.

[17] Order, ¶ 87 (calling area is "difficult to quantify and cannot be systematically incorporated in the template in a manner that appropriately reflects all circumstances").

they believe that such factors affect the comparability of rates in their jurisdictions."[18] While this recognizes the problem, it also imposes unreasonable limitations. First, if the Commission does not collect nationwide data on calling area sizes, it will be very difficult for an individual state to know, never mind prove, how its calling areas compare with the national average. At the least, the Commission should collect data on calling area size in its survey forms.

But there is a more serious problem. A support system cannot be either specific or predictable[19] if it is based on a promise to consider important facts on an *ad* hoc basis. The way to make support predictable and specific is to publish in advance a method for measuring local calling area size and to use the resulting data to adjust support entitlements.

Commenters were asked to describe in detail any proposed methodologies for normalizing the impact of calling scopes on rates.[20] Any adjustment solely for local calling area should take into account both the size of the local calling area (i.e., square miles) and the number of lines that can be reached by local calling. Ideally, the adjustment should also take into account the proportion of customers who have within their local calling areas all essential governmental and commercial services, such as schools, fire departments, police, commercial areas, doctors and hospitals. This last correction may indeed be, as the Order describes, too "difficult to quantify." It is well within the capabilities of modern GIS technology to measure square mileage of calling areas with known boundaries, and the line counts of each wire center are reported quarterly to the Commission.

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[18] Order, ¶ 59.

[19] *See,* 47 U.S.C. § 254(b)(5).

[20] Order, ¶ 113.

A simpler solution to normalizing for local calling area size is to adopt total (toll and local) intrastate per-line revenue as the primary measure of local rates. This can be used as a proxy for size-normalized local exchange rates because customers with large local calling areas do not need to make short-haul toll calls.

3. Customer Option Plans.

Tariffed data on local rates can become unreliable when customers have a choice of plans. Verizon customers, in Vermont, for example, have available a "low usage" package that does not include any pre-purchased minutes of local usage. That option is selected infrequently, however, as most customers purchase a "standard" service that includes the pre-purchase of a stated number of local usage minutes.

This problem proved quite serious in the GAO study.[21] That study reported that all sampled residential rates in the state of Michigan are $43.95 per month. However, a footnote indicates that most residential customers in Michigan actually purchase a message-rate service that allows 400 calls per month and costs $12.01.[22] In other words, if one disregards customer option plans and actual customer choice, Michigan has the highest rates in the land. But, if one considers what most customers actually pay, the cost to Michigan customers is in the low-average range. If the Commission's contemplated new system of supplemental rates-based support is to be anything more than a lottery, the Commission must remove this kind of variability from the input data.

[21] *Federal and State Universal Service Programs and Challenges to Funding*, United States General Accounting Office, Report GAO –02-187, Feb. 2002, Appendix IV, Local Telephone Rates, p. 53.

[22] *Id.,* p. 59.

In toll services, the increasingly popular "bucket of minutes" plans have made rate measurement very difficult. The *Reference Book* even acknowledges that these plans for toll services have made[23] toll tariffs largely meaningless. The same phenomenon is occurring with local usage. Plans that mix toll minutes with local minutes have been available from wireless carriers for years. Now they are becoming available from wireline carriers.[24] In a narrower context, the *Reference Book* acknowledges this problem:

> . . . [O]ne of the challenges for the future will be to monitor developments in an evolving marketplace, where carriers (such as wireline, wireless, and cable) are offering consumers bundled packages of local and long distance service, and buckets of minutes that can be used to call anyone, anywhere, and anytime.[25]

If toll-and-local "bucket of minutes" packages will make monitoring a "challenge," they will severely hamper the more difficult task of distributing universal service support on a specific and predictable basis. Even assuming, for the sake of argument, that tariffed local exchange rates are meaningful today, these packages will soon have the same effect on nominal local exchange rates that they have already had on toll-only optional packages.

The need for adjustment for optional packages is the most fundamental challenge to the Commission's decision to base support on rate data. If there were to be a single reason why the Commission should reexamine whether local rates are a plausible basis for providing support, the

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[23] "The increased availability and marketing of discount and promotional long distance plans as well as the popularity of wireless "bucket-of-minutes" plans has made the basic schedule rates obsolete for many long distance customers, particularly business customers and high volume residential consumers." *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service, 2003*, Industry Analysis Division, at iii,

[24] UNE-P-based carriers have apparently led the way, but they are not alone. All incumbent carriers in Vermont either have adopted or are considering adopting such bundled service plans. If a substantial number of customers should shift to these blended packages, some method will be needed to calculate the "local service" portion of the total package price.

[25] *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service, 2003*, Industry Analysis Division, at iii.

customer option package is that factor. Solutions to this problem may be available, but they may require more complexity in data collection than the Commission has anticipated. The Vermont Board suggests two possible solutions:

a. Collect data on the actual average local exchange payment included in the most popular optional plan. This option, however, still leaves unsolved the problem of how much of a "bucket of minutes" package price should be allocated to local exchange service.

b. Collect data on the total intrastate revenue of the carrier. Once again, this option avoids the difficulty entirely. There is no need to allocate revenue between intrastate local and intrastate toll.

4. Local/Toll Balance.

Even where two states may have calling areas of similar scope, they may have quite different local exchange rates.[26] State A may have high intrastate toll charges and low local exchange rates. State B, otherwise similar in geography, demographics and calling area size, may have the opposite policy, with low toll rates and high local exchange rates. To correct for this difference, the commission should adjust local rates to the level that would exist if all carriers charged the same toll and access rates.

If the Commission should fail to account for the balance between local and toll revenues, high-cost states will have an incentive to raise local exchange rates and reduce intrastate toll and access revenues. The Commission may desire states do this, but it nevertheless is a matter within state authority. The Commission should not make federal support contingent on states surrendering jurisdiction over intrastate rates.

[26] *See, e.g.,* Order ¶ 15.

Once again, using total per-line intrastate revenue can solve this problem automatically. Since toll and local revenues are included in the input data, differences in the revenue balance between local and toll would be irrelevant to the results.

5. Business/Residential Balance.

The FNPRM specifically asked whether the Commission should require states to file data related to business rates, in addition to residential rates, and noted that a meaningful state-to-state rate comparison may necessarily include business rates in addition to residential rates.[27]

States vary in the degree to which business rates exceed residential rates. According to the GAO Report, Ann Arbor, Michigan has residential rates of $43.95 and business rates of $30.84. By contrast, Jacksonville, Florida has residential rates of $10.46 and business rates of $28.43. If these data are accurate, they show that Florida and Michigan have quite different views about business customers paying more so that residential customers may pay less. States, like Florida, that have decided this question in the affirmative should be entitled to show that their ratepayers are carrying a heavier burden than is apparent from the data reflecting only residential rates.

If the Commission does indeed require states to file residential rate data as a part of its rate review and expanded certification process, it would not be unduly burdensome to also require states to file business rate data. The states could collect business rate data at the same time as residential data, and from the same sources.

If the Commission should fail to account for the balance between business and residential rates, high-cost states would have an incentive to increase residential rates and decrease business

[27] ¶ 110.

rates. The Commission may desire that states do this, and it may be good economic development strategy for those states, but those questions are nevertheless a matter within the authority of the states. The Commission should not make federal support contingent on states surrendering jurisdiction over intrastate rate designs.

Once again, using total per-line intrastate revenue can solve this problem automatically. Since business and residential revenues are included in the input data, differences in rates between the two classes would be irrelevant to the results.[28]

Use of Total Intrastate Per-Line Revenues.

We explained above that if the Commission were to adopt total intrastate revenues per line as a proxy for local exchange rates, numerous problems could be avoided. We mention the matter again here to emphasize that this substitution could solve *all five* of the problems. It includes local measured service revenues. It includes short-haul toll data, and thus corrects for local calling area size. It solves the uncertainties surrounding customer option plans because all jurisdictional revenues are included. It solves the toll/local balance problem because where toll rates are high, toll revenues automatically increase and are included in the collected data. Finally, it solves the business/residential balance problem because revenues from both business and local customers are included.

II. BURDEN OF COLLECTING AND REPORTING

The Commission stated that it anticipates that each state will have assembled much of the additional data described in the FNPRM in the course of performing rate reviews.[29] This is not

[28] The Vermont Board also notes that a rates-based support system could create an incentive to fail to actively regulate incumbent rates. Since increased federal support could follow upon increased rates, state commissions could reduce their scrutiny of rate-regulated carriers. Regulatory commissions and companies could (continued….)

necessarily true. Rate reviews are ordinarily performed based on an incumbent carrier's embedded cost. First, a carrier's cost of service is evaluated to determine if there is a revenue excess or deficiency. If there is no imbalance, the process halts. If revenues are insufficient, the state commission typically evaluates which specific rates should be increased. Even then, the state commission may accept recommendations of the company affected or the public advocate, without engaging in a comprehensive data collection effort on the status of all rates. This shows that state commissions do not routinely develop all of the kinds of data contemplated in the FNPRM. The added cost of data collection on state commissions could be substantial. Once again, however, if the Commission were to collect instead total intrastate revenue per line, data collecting and reporting requirements would be insignificant. All regulated incumbent carriers should have this information already, and many carriers report it routinely through the ARMIS system.

III. EXPLICIT UNIVERSAL SERVICE FUND

The FNPRM asked whether states should be required to file information annually related to their efforts to advance universal service by adopting explicit universal service mechanisms, such as the establishment of explicit state universal service funds. The Notice suggests that this information might aid the Commission in assessing the sources of any problems with rate comparability to determine whether additional federal actions are necessary.

The Commission need not collect information related to the existence and size of any explicit universal service support mechanisms established in the states. Those data have already

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agree to increase spending on facilities for services that are not supported by universal service, and the resulting rate increases could lead to federal universal service funds being used improperly.

[29] Order, ¶ 109.

been collected by the states and the National Regulatory Research Institute. If the Commission wishes to learn more about state universal service programs, it should participate in the State Universal Service Administrator's Group, currently chaired by Jeff Pursley, a staff member of the Joint Board.

The Commission should not require the states "to identify implicit support flows in the rate structure, including implicit support flowing from business line rates to residential line rates, from geographically averaged rates, or from intrastate access charges."[30] Those matters are within the reserved jurisdiction of the states. More basically, there is no single accepted method to define "implicit support flows." Nearly all statements that assert the existence of "implicit support" presuppose a particular allocation of joint and common costs. Since nearly all costs in telecommunications are joint and common, "implicit support" is largely in the eye of the beholder.

The Commission has no duty under Section 254 to intrude on state ratemaking decisions or to characterize particular state rates as containing "implicit support." The only possible statutory basis for such actions is 47 U.S.C. § 254(e), which requires that *federal* support be explicit, and does not apply to state universal service programs or state rate designs. Some states support their rural high-cost areas through explicit universal service funds. However, the majority of states continue to have geographically uniform rates (or nearly so) for individual

[30] FNPRM ¶ 110.

carriers. Both paths lead to comparable rates in rural areas, and the Commission should not express a preference for one decision over the other.[31]

The *Qwest* Court directed the Commission to consider creating incentives to encourage the states to carry out their own section 254 responsibilities.[32] But nothing in the Court's decision suggests that:

1) states have a duty under the Act to accept the Commission's judgment on joint cost allocations; or

2) states have a duty under the Act to convert implicit support into explicit universal service programs; or

3) the Commission can provide less than sufficient support to a state that has not shown that rates within its own borders meet the Commission's standards of reasonable comparability.

The Commission should affirmatively state that federal support is not conditioned upon any actions that a state takes within its own borders regarding local exchange rates or other intrastate services. To do otherwise would not only withhold sufficient support, but it would intrude on the jurisdiction reserved to the states over intrastate rates.[33]

[31] We do note that the Commission has substantial opportunities to eliminate geographically averaged rates for interstate jurisdiction. For example, cellular carriers typically charge uniform rates nationally. NECA also offers uniform national tariffs for some interstate services.

[32] *Qwest v. FCC*, 258 F.3d 1191 (10th Cir. 2001).

[33] *See* 47 U.S.C. § 152(b).

IV. PROCESSING OF STATE REQUESTS

The FNPRM sought comment on how to treat any state requests for further federal action, including procedures for states to submit any such requests, required showings by requesting states, and how to calculate any additional targeted federal support.

A. Procedures for Filing and Processing Any State Requests for Further Federal Action

1. Timing of Requests for Further Federal Action

The FNPRM sought comment on the timing of state requests for further federal action. The FNPRM postulated that any state request for further federal action will arise from the state rate review process and the expanded certification, and any state requests for further federal action are likely to rely on the same data. To promote simplicity, it proposed that a state should be permitted to make a request for further federal action only concurrently with the filing of its expanded certification regarding the comparability of its rural rates in areas served by non-rural carriers.

The Vermont Board believes that this proposal is reasonable, but two exceptions should be recognized. First, initial applications should be allowed at any time of year. Depending on the timing of the annual application, states may have to wait as long as a year to make an initial application. If rates are not currently comparable, administrative convenience is not a sufficient reason for such a delay. Second, extraordinary circumstances may from time to time require a state to make application at a time when the annual window is closed. For example, a natural disaster could impose substantial costs on a carrier that has limited access to capital. Waiting an entire year for relief, could impair a carrier's ability to raise capital and result in the postponement of necessary repairs and the construction of new facilities. Prompt extraordinary

relief may be justified under those circumstances, and should not be prohibited to promote administrative convenience.

The FNPRM also sought comment on how frequently a state should be required to seek further federal action if the state's request is granted the first time. The Vermont Board suggests that the Commission should not establish a "one-roll-of-the-dice only" rule. The situation is similar to that formerly faced by Bell companies applying under Section 271. Initially, the rules for 271 applications were based largely on statute. As the Commission developed experience, however, it announced many new standards in case decisions. The Commission's decisions not only resolved pending applications, but provided a road map for future applications. It would have been unfair in the extreme to have barred an early applicant from reapplying once the criteria for approval were better defined.

Petitions for supplemental relief are the same. If a state fails to receive relief, it may be that the state has not understood the Commission's policies regarding one or more of the factors that the Commission considers in deciding such applications. Since the Commission anticipates developing these criteria through specific decisions rather than a prescribed formula, it is likely that the case law will evolve quickly, at least during the next few years. States should no more be barred from reapplying for supplemental support than Bell companies were barred from making sequential applications under section 271.

The Commission need not worry about frivolous applications. The costs of presenting such a case will likely be substantial, and states should not be presumed willing to waste resources on frivolous sequential applications.

The FNPRM asked whether a state be required to seek further federal action every year. The Vermont Board presumes that most cases for supplemental relief will be based largely upon

existing rates and demographic factors. Neither of these change very rapidly. While it may be reasonable to impose a condition requiring reasonable annual data reports, the Commission should not require full relitigation of the underlying issues every year. A reasonable sunset period could be provided, possibly five years, or a period determined at the time of making the support decision that is dependent on the specific circumstances.

2. Required Showings

The FNPRM also sought comment on the required showing in order to demonstrate a need for supplemental support. In the interest of making the process as specific and predictable as possible, the FNPRM sought comment on the showings that a state should be required to make in support of a request for further federal action. The FNPRM suggested two:

a. a demonstration that rural rates in non-rural carrier service areas in the state are not reasonably comparable to urban rates nationwide, including an analysis of the rates in the basic service template and other relevant factors; and

b. a demonstration that the state has taken all reasonable actions to achieve reasonable comparability of its rural rates to urban rates nationwide, including an explanation of how the requesting state has used any federal support currently received to achieve comparable rates and whether it has implemented a state universal service fund.

The Vermont Board supports these requirements. However, for the reasons stated above, the Vermont Board also recommends that the Commission clarify that no state has an obligation to show that it has replaced "implicit support" with an explicit geographically oriented universal service program, and no state need show that it has taken any other particular action with regard to intrastate rate design of incumbent carriers.

The Vermont Board also recommended above that the Commission require data collection, and establish prescribed adjustments for five factors: usage-sensitive charges; local

calling area size; customer option plans; local/toll balance; and business/residential balance. While this does increase the burden on all states, the Commission cannot operate this new system successfully without a data set that includes substantially all of the country. If it goes forward with rates-based support, the Commission should require that all states provide information on all five of these factors so that nominal rates can be normalized.

The FNPRM also sought comment on the showing required regarding the first element of the Joint Board's recommended test, a demonstration that rural rates within the state are not reasonably comparable to urban rates nationwide. As the Commission suggested, an applicant state should be permitted to rely on the presumption that an area with local rates below the nationwide urban rate benchmark complies with section 254. As noted above, the Commission should also consider local measured service charges, local calling area size, customer option plans, the local/toll balancd, and the business/residential balance. In the alternative, the Commission could collect one single data point for each jurisdiction, total intrastate revenue per line.[34]

The FNPRM also sought comment on what state actions should be considered reasonable and necessary to support a request for further federal action for purposes of the second element of the Joint Board's recommended showing. In particular, the FNPRM sought comment on the extent to which states must "reform their universal service support mechanisms" in order to be

[34] The FNPRM asked what weight the Commission should accord additional non-rate factors that the state contends are relevant in determining whether rural rates in a state are reasonably comparable to urban rates nationwide. As explained above, if the new rates-based support system is to comply with the statutory requirement that support be specific and predictable, the Commission must collect valid, reliable and consistent data on five issues, and it must use that data to make specific prescribed adjustments to raw rate data.

able to demonstrate that they have taken all reasonably possible actions to achieve rate comparability. In this regard, the FNPRM noted that:

> the Act strongly favors explicit support mechanisms, which are less vulnerable to erosion in competitive markets than implicit support mechanisms. Although states are not required to adopt explicit mechanisms to support universal service, we propose that a state that has not done so cannot be deemed to have taken all reasonably possible steps to support rate comparability within the state, the requirement recommended by the Joint Board.

The NPRM further proposed that, in order to enable the Commission to determine whether a state has made its universal service mechanisms explicit, a state requesting further federal action should be required to explain the extent to which it has made its universal service mechanisms explicit, and file supporting data, including rate data for residential and business lines in rural and urban areas served by non-rural carriers. The FNPRM also asked whether the rebalancing of residential and business rates be required in support of a request for further federal action.

As explained above, the Vermont Board believes that the Act and the *Qwest* decision are both consistent with the following three principles:

1) States have no duty to accept the Commission's judgment on joint intrastate cost allocations;

2) States have no duty to convert implicit support into explicit universal service programs or to "rebalance" rates in a way that complies with the Commission's ideas about underlying cost allocations; or

3) The Commission cannot provide less than sufficient support because a state has not shown that rates within its own borders meet the Commission's standards of reasonable comparability.

3. Types of Further Federal Action

The FNPRM sought comment on the types of further federal action that may be provided to requesting states if the Commission determines that further federal action is necessary in a particular instance, including possible methods of calculating any additional targeted federal support. As suggested in the FNPRM, additional targeted federal support is the obvious solution when cost-based support is demonstrably insufficient to allow a state, despite reasonable efforts to equalize rates within its own borders, to provide nationally comparable rates to all its citizens.

The FNPRM also asked whether the Commission should take action where the state commission lacked the authority to do so regarding the scope of local calling areas and the quality of service. The Vermont Board has no objection to the Commission acting where states have abandoned the regulatory field.

4. Forward-Looking Cost

The FNPRM proposed that any additional targeted federal support should equal a set percentage of estimated forward-looking wire-center costs in excess of two standard deviations above the average cost per line.[35] The Commission stated a belief that this method for calculating any additional targeted federal support would be specific and predictable, and provide consistency with the non-rural support mechanism, which also uses model cost estimates to calculate and target support. The Commission also stated a belief that this method would provide a fair and equitable means of determining any additional targeted federal support and avoid inappropriate incentives that might be created if it were to base any additional targeted federal support on rate levels in a particular area. The Commission should reject this proposal

[35] FNPRM ¶ 122.

because it is almost certain to be based on an inaccurate diagnosis of the underlying problem, and because, as a result, it will produce too much or too little support to fix the problem.

Under the existing system, it cannot be true that a carrier's above-benchmark costs are receiving inadequate support. Under the existing system for nonrural carries, 76 percent of above-benchmark costs are covered by explicit model-based support. This presumably covers all costs above the benchmark that separations has assigned to the intrastate jurisdiction. The remaining 24 percent of cost are presumably separated to the interstate jurisdiction and recovered there. In other words, the existing system already provides for recovery of *all above-benchmark costs*.

Under the postulated facts, a carrier that already has 100 percent of its above-benchmark costs recovered will, with its state commission, appear before the Commission with proof that its rates are not reasonably comparable to urban. Under those postulated facts, the obvious problem is that there is a mismatch between the existing support and the existing rates. That necessarily means that there has somehow been a mismatch between rates and the model. One obvious source of such a mismatch is the basic fact that most state commissions do not set rates based on the Commission's cost model. Another distinct possibility is error in the model. The model is still running largely on input data from 1999 and before. Moreover, the Commission has not made any but the most basic adjustments to the model since 1999, despite serious reservations among many parties concerning its accuracy and reliability.

The obvious diagnosis under the postulated facts is that rates are too high precisely *because the model has failed to address* the problem. Increasing the cost recovery above 100% of above-threshold model costs may provide further symbolic expression of the Commission's commitment to modeling, economic theory and competition. But it would be misdiagnosing the

problem. Although the proposal would provide needed relief to high-cost states, the amount of that support would almost certainly be too large or too small to solve the problem of non-comparable rates. Perhaps the Commission cannot know now *why* a state's rates are still too high after receiving model-based support; but it can be certain now that increasing the dosage of the model above 100 percent won't solve the problem without spending too much or too little.

The FNPRM asked whether there is another proposed method that, based on some measure other than forward-looking cost estimates, would provide a more appropriate basis for calculating any additional targeted federal support. Commenters were asked to describe the method with specificity.

If the Commission were to calculate support as a function of the carrier's rates, support would be sufficient yet not excessive. Rates are the basic concept of supplemental support, and the Order relies upon rates-based support to justify its compliance with the *Qwest* decision.

The Commission cannot grant support equal to 100 percent of the difference between a rate benchmark and current rates (or, better, average revenues). To do so would create perverse incentives for states and carriers. Neither can the Commission grant only a small percentage of that difference, because that support would be insufficient. A reasonable proposal would be to provide support equal to 75 percent of the rate (or revenue) difference between the applicant carrier's rates and national average urban rates. By declining to pay for 25 percent of the rate excess, the Commission can avoid creating a perverse incentive for commissions and companies to increase rates primarily in the hope of increasing support.

The FNPRM proposed that additional targeted federal support should be provided to wire centers in qualifying states with costs per line exceeding a benchmark of two standard deviations

from the average cost per line among all non-rural carrier wire centers nationwide.[36] The Commission explained that this means wire center costs in excess of $40.85, or 189 percent of the nationwide average cost per line. The FNPRM states that in these wire centers it is likely to be more difficult to achieve rate comparability, despite otherwise sufficient state resources and federal support. The Commission stated its belief that this method would provide an effective means of calculating any additional targeted federal support for any qualifying state in a specific, predictable and consistent manner. The FNPRM asked if two standard deviations was an appropriate threshold for this purpose and asked whether support should be set at 5 percent or 25 percent of costs in excess of two standard deviations above the average. The Commission stated its belief that this proposal is consistent with the current and past methodologies for determining high-cost support for non-rural carriers and would provide meaningful support to assist states in resolving any rate comparability issues that combined federal and state action have failed to resolve.[37]

This proposal bears a striking similarity to legislation promoted by Qwest, but it has nothing else to recommend it. The proposal is necessarily premised on two inappropriate conclusions.

First, the proposal assumes that rates paid by customers in each wire center (and the price that competitors are paying for UNEs) differ from one wire center to another, based on the forward-looking model-based costs in that wire center. Yet as the Commission recognized in the

[36] The non-rural support mechanism, as amended in the foregoing Order, calculates support by comparing the statewide average cost per line, as estimated by the Commission's cost model, to a nationwide benchmark of two standard deviations above the average cost per line.

[37] FNPRM ¶ 124.

Order, most states have not deaveraged rates to the wire center level. Indeed, many states have refrained from doing so because they believe this is an inappropriate policy. Therefore providing rates-based support at the wire center level will provide the wrong amount of support to incumbents and will introduce new opportunities for arbitrage by competitors. Some states with rates that barely exceed the threshold will receive a great deal of support because they have a widely dispersed geographic cost profile. Even if rates are only slightly high, a few wire centers with very high model-based costs can be worth millions.

Second, the proposal assumes that a state that has low average costs, but some high-cost wire centers, should receive federal support, even if the other residents of that state do not contribute. Support based on individual wire center costs is contrary to the reasoning underlying state averaging. Under policy established in the Seventh and Ninth Orders, and reaffirmed in the Remand Order,[38] a state with low average costs should use its own resources first in order to reduce rates in high-cost areas. Therefore, the proposal in the FNPRM to provide support based upon the un-averaged cost of particular wire centers would provide excess support in some areas, more than is required by Section 254, and less than is sufficient in other areas.

V. ADDITIONAL INDUCEMENTS FOR STATE ACTION

The Commission sought comment on whether to make additional targeted federal support available for high-cost wire centers in states that implement explicit universal service mechanisms.[39] The purpose of additional targeted federal support would provide each state with

[38] "We also agree with the Joint Board that the general framework of the non-rural mechanism, through the use of statewide average costs, reflects the appropriate division of federal and state responsibility for determining high-cost support for non-rural carriers." Order ¶ 24.

[39] FNPRM ¶ 126.

a direct incentive to make its universal service support mechanisms explicit, rather than implicit. The FNPRM maintains that section 254 states a "clear preference for explicit, rather than implicit, support," but the Commission admits that the 1996 Act does not require states to adopt explicit universal service support mechanisms.[40] The FNPRM sought comment on whether it has "an interest, other than the aspirational provisions of the Act, in states' decisions to adopt explicit mechanisms or to rely on implicit support flows."[41]

The Vermont Board does opposes using federal universal service support mechanisms to create an incentive for states to alter their intrastate rate designs. Unlike the Commission, Vermont does not find any such requirement in section 254, even in the "aspirational" provisions in subsection (b). The only provision in section 254 that could conceivably provide a basis for making support explicit is found in subsection (e), which applies to *federal* support. There is no statutory mandate to induce states to "reform" their rate designs by making them conform to the Commission's ideas about the areas where rates should be high or low, or the kinds of customers whose local rates should be reduced. Moreover, the Act explicitly disdains any implied preemption of state authority.[42]

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[40] FNPRM ¶ 127.

[41] *Id.* The FNPRM did not explain which "aspirational provisions" in subsection (b) it relied upon in concluding that the Act encouarages it to induce states to adopt explicit support mechanisms.

[42] The Telecommunications Act of 1996 expressly disclaimed any implied effect of preemption. In an uncodified section, it provided as follows:

> (1) No implied effect. - This Act and the amendments made by this Act shall not be construed to modify, impair, or supersede Federal, State, or local law unless expressly so provided in such Act or amendments.

Pub. L. 104-104, title VI, § 601(c)(1), Feb. 8, 1996, 110 Stat. 143 (text reprinted in note following 47 U.S.C.A. § 152 (West 2001)).

Moreover, any such extra-statutory program under section 254 would produce unnecessary support. This could add to the considerable financial strain the universal service program is already under, and the new program could jeopardize the Commission's ability to complete its other obligations, such as providing sufficient support to states with high rates and costs. The Commission should refrain from offering yet another universal service program until it is certain that it has sustainable revenues to provide sufficient support for those programs actually envisioned by section 254.

VI. SUMMARY

The Commission should reexamine its decision to base supplemental support on local exchange rates. If it decides to go forward, it will have to solve difficult methodological problems. It will have to require rate reporting from substantially all of the country, and it will have to develop both reliable data and specific adjustments for five factors that make bare rate data arbitrary. Failure to take these steps would open the decision to attack as arbitrary and capricious and, therefore, subject to risk of appellate reversal. In the alternative, the Commission could still move forward on a rates-based supplemental support program if it used total intrastate revenues per line as the single input element. This data point solves all five of the problems identified with using local exchange data.

For those states that succeed in becoming eligible for supplemental support, the Commission should not calculate that support based on the cost proxy model. Support based on that model already provides 100 percent of above-benchmark costs, and providing more would be neither sufficient nor consistent with the reasoning the Commission has repeatedly adopted for statewide averaging.

The Commission should not use its Section 254 power to induce states to alter intrastate rate designs. The 1996 Act preserves state authority under section 152(b), and the Commission cannot condition federal support upon a state commission acquiescing in the Commission's preferred allocation of joint intrastate costs or in adopting rate designs preferred by the Commission.

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